United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7235

To be argued by
GEORGE A. DAVIDSON

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P/S

United States Court of Appeals
For the Second Circuit

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Plaintiff-Appellant,

against

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,

Defendants-Appellees,

and

DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,

Defendants.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF PLAINTIFF-APPELLANT WINTHROP J. ALLEGAERT, TRUSTEE IN BANKRUPTCY OF duPONT WALSTON INCORPORATED

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UNITED STATES COURT OF APPEALS
For the Second Circuit

No. 76-7235

WINTHROP J. ALLEGAERT, as Trustee
of duPont Walston Incorporated,

Plaintiff-Appellant,

-against-

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS
CORPORATION, duPONT GLORE FORGAN
INCORPORATED, WILLIAM K. GAYDEN,
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CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS
CORPORATION, NEW YORK STOCK EXCHANGE, INC.,
DANIEL J. CULLEN, WILLIAM D. FLEMING,
GEORGE T. THOMSON and CHARLES W. COX,

Defendants-Appellees,

-and-

DOUGLAS E. DeTATA, JOHN J. DOUGHTY,
ALLAN BLAIR, and D. TIPP CULLEN,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT WINTHROP J. ALLEGAERT,
TRUSTEE IN BANKRUPTCY OF duPONT WALSTON INCORPORATED

Preliminary Statement

Winthrop J. Allegaert, the trustee in bankruptcy of duPont Walston Incorporated (the "Trustee"), appeals from a memorandum and order entered on April 14, 1976 (J.A. 400) and an order entered on May 6, 1976 (J.A. 430) by District Judge Whitman Knapp in the Southern District of New York. These orders, neither of which is officially reported, stayed this action pending arbitration and ordered the parties to agree upon an appropriate arbitrator, in default of which the American Arbitration Association would be appointed as the arbitration tribunal.

Issues Presented

1. Whether a bankrupt's arbitration agreement can be specifically enforced against a trustee in bankruptcy.

2. Whether statutory claims arising under the Bankruptcy Act, the Securities Act of 1933, and the Securities Exchange Act of 1934 may be determined by an arbitrator.

3. Whether a district court may appoint a substitute arbitration tribunal when the designated tribunal was central to the agreement to arbitrate and the designated tribunal is disqualified.

4. Whether trial of claims over which the federal court has exclusive jurisdiction may be stayed pending arbitration of issues pertaining to those claims.

Statement of the Case

Plaintiff-appellant Winthrop J. Allegaert is the trustee in bankruptcy of duPont Walston Incorporated (hereinafter "Walston" or the "Bankrupt"). Prior to bankruptcy Walston had been one of the largest retail brokerage firms in the country.

The Trustee's complaint, which names twenty defendants, alleges a complex scheme under which defendants siphoned off the assets of Walston to another brokerage firm and caused the liabilities of the other firm to be shifted to Walston, thereby resulting in Walston's bankruptcy. The twenty-four counts of the complaint allege violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Bankruptcy Act, the Delaware General Corporation Law, the New York Business Corporation Law, the New York General Business Law, and the common law. The prayer for relief seeks actual damages of $45 million from all defendants and punitive damages in a like amount from certain defendants. The case represents the principal potential for a meaningful distribution to creditors of Walston.

Service of process took place in five states and witnesses reside in at least one other state. The Trustee has, of course, no personal knowledge of the facts and has few of the relevant documents since defendants are in possession of Walston's records for the period after their scheme was

implemented. Accordingly, the Trustee has brought the case in federal court where pre-trial discovery is available, the judges are expert on the areas of federal substantive law involved, and the decisions reached are subject to appellate review.

This case concerns H. Ross Perot's efforts to extricate himself, at the expense of Walston and its creditors, from a disastrous involvement with the brokerage industry. The scheme charged to the defendants is alleged in detail in paragraphs 20 through 63 of the complaint (J.A. 13-42) and will be summarized only briefly here. Perot is the founder and a 62 per cent stockholder of Electronic Data Systems Corporation ("EDS"), a company which operates the data processing systems of corporate customers under long-term contracts. During the late 1960's continued geometric growth of EDS profits caused EDS stock to trade at extraordinary multiples of earnings. In 1970, Perot began to invest heavily in the brokerage firm later known as duPont Glore Forgan Incorporated ("duPont Glore Forgan"), thereby preserving the firm as a major customer of EDS. Perot's investment in duPont Glore Forgan eventually reached about $70 million and gave him virtually complete ownership of the firm. This investment was highly leveraged. Perot had borrowed most of the money from banks and had pledged much of his EDS stock as collateral. In turn, the value of the EDS stock was heavily dependent on continued income from the contract with duPont Glore Forgan (J.A. 13-17).

The business of duPont Glore Forgan foundered badly under Perot's stewardship. By the spring of 1973, duPont Glore Forgan's accumulated losses had eroded the firm's capital to the point where the firm was on the verge of being liquidated. The liquidation of duPont Glore Forgan would have meant the loss of nearly all of Perot's investment in the firm and, because of the highly leveraged nature of the investment, threatened his entire financial empire (J.A. 19-20).

To escape the consequences of a duPont Glore Forgan liquidation, Perot proposed a plan (the "Perot Plan") to another brokerage house, Walston, in which Perot was a minority investor. The Perot Plan called for a series of unusual transactions pursuant to a number of "realignment agreements" by which Walston would assume all front office operations of the two firms and duPont Glore Forgan would assume all of the back office operations (J.A. 21-22). Under the Perot Plan, all of the liabilities of duPont Glore Forgan's failing branch office system would be shifted to Walston, including lease liabilities on dozens of offices, many of which had already been closed. In addition, Walston would be required to pay <u>all</u> of duPont Glore Forgan's expenses and to make a $3 million dollar advance on those expenses. In addition, Perot would exchange his non-voting preferred stock in Walston for a new series of preferred stock carrying more voting rights than all of Walston's common stock. By thus obtaining control of Walston -- without paying for it -- Perot could be assured that Walston

would act in accordance with the Perot Plan. Under the plan, duPont Glore Forgan's capital, which had been eroding swiftly, would be fully protected against future loss. On the other hand, Walston would be saddled with the crushing liabilities of duPont Glore Forgan's failing branch system (J.A. 22).

All but a few of Walston's 20 directors were kept in the dark as to the terms of the Perot Plan until shortly before the Board meeting scheduled for Sunday, July 1, 1973 at which the plan was to be considered. One day prior to that meeting the directors were given drafts of the numerous, lengthy and enormously complex realignment agreements* by which the plan was to be accomplished. The Board meeting stretched from Sunday morning to the early morning hours of the following day; during that period, representatives of the Perot interests made numerous material misrepresentations, failed to disclose material information, and promised improper benefits to directors in return for their votes (J.A. 25, 30-37, 39).

In addition, the New York Stock Exchange, Inc. ("NYSE") concealed material information on Walston's prospects under the plan and concealed its own substantial financial stake in the outcome of the vote. Thus, the NYSE failed to disclose the conclusion reached by its own staff that Walston's excess net capital would be completely depleted in eight months if the Perot Plan were adopted. Furthermore, the NYSE failed to disclose

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* The final versions of the realignment agreements are reproduced at J.A. 76-284.

that it had an interest in saving duPont Glore Forgan, since the NYSE's Special Trust Fund would have been liable to Perot on a $15 million note on the liquidation of duPont Glore Forgan, and the Special Trust Fund was not then in the possession of sufficient funds to make the payment (J.A. 35, 37).

Finally, after a member of Walston's Board opposed to the plan departed to his hotel room Sunday night because of illness, a vote was taken on the plan. Ten directors, including two nominees of Perot, voted in favor of the plan and nine voted against it. Although Walston shareholders were told that they were to have a vote on any transaction with duPont Glore Forgan, no shareholder vote was held (J.A. 39).

After the Perot Plan was effectuated, all of Walston's accounting, record-keeping and disbursing functions were performed by duPont Glore Forgan. In the first six months of operation under color of the realignment agreements, Walston lost over $30 million and, as the NYSE had predicted, Walston was forced to liquidate its business (J.A. 42). Arrangements were made in January, 1974 to dispose of the branch office network, and on March 27, 1974 Walston filed a petition for reorganization under Chapter XI of the Bankruptcy Act. On May 29, 1974 Walston was adjudicated a bankrupt and Winthrop J. Allegaert was appointed trustee (J.A. 9).

Prior to the effectuation of the realignment agreements Walston had equity of more than $30 million (J.A. 28); at the time of its bankruptcy, it had assets of under $2 million against creditors' claims of over $75 million.

The Trustee filed his complaint on July 1, 1975, naming as defendants Perot, duPont Glore Forgan, EDS, an EDS subsidiary, the NYSE, several Perot associates and investment vehicles, and the Walston directors who voted in favor of the Perot Plan. Although all defendants were served with process and with interrogatories and document requests, no response was made to any of these papers. Rather, on October 14, 1975, fifteen of the twenty defendants (the "Perot Group") moved for a stay of this action pursuant to Section 3 of the United States Arbitration Act, 9 U.S.C. § 3, pending arbitration of the claims alleged in the complaint (J.A. 68). The Perot Group alleged that they had a right to arbitrate with the Trustee based upon three arbitration contracts which were allegedly binding upon the Bankrupt.

In addition, the NYSE moved for a stay of the action based upon the court's inherent power to control its docket (J.A. 64). The NYSE conceded that it had no right to arbitrate with the Trustee but moved for a stay pending arbitration by the other parties on the ground that such a stay would result in judicial economy and economy to the litigants.

The provisions relied on by the moving defendants are the arbitration clauses in the NYSE and American Stock Exchange ("AMEX") constitutions and a provision of one of the realignment agreements by which the Perot Plan was effectuated.*

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* The texts of these provisions are set forth in full at pp. 47-48, *infra*.

The clauses all called for arbitration before either the NYSE arbitration tribunal or the AMEX arbitration tribunal.

The arbitration motions were argued before Judge Knapp on November 14, 1975. On April 14, 1976, Judge Knapp issued a memorandum and order giving his reasons for granting the motions (J.A. 400), and on May 6, 1976 an order was entered staying the action as to all defendants (J.A. 430). On May 14, Judge Knapp issued another memorandum and order to make it clear that the Trustee would not be entitled to discovery except under special circumstances (J.A. 434).

The major error that permeates Judge Knapp's opinion is his failure to recognize that under the statutory scheme of the Bankruptcy Act a trustee is a different legal entity from the bankrupt with a different set of rights and duties and is not bound by agreements made by the bankrupt.

The court did consider the trustee's unqualified statutory right to reject executory contracts of the bankrupt, but erroneously concluded that an arbitration agreement is not an executory contract (J.A. 408-09).

Furthermore, the court failed to recognize that when the trustee sues to recover transfers voidable under the Bankruptcy Act he is acting for and standing in the shoes of the creditors and not those of the bankrupt. Although there was no precedent requiring a trustee to go to arbitration when suing under the Bankruptcy Act to recover voidable transfers,

Judge Knapp concluded there was a "rule" in this Circuit that a trustee can be compelled to arbitrate such an action (J.A. 414).

Despite substantial authority and persuasive policies to the contrary, Judge Knapp held that statutory rights under the Bankruptcy Act and the securities laws could be determined by an arbitrator (J.A. 413-16). Thus, the district court would have the rights of the Trustee and the hundreds of Walston creditors who never agreed to arbitration determined by a tribunal where discovery is not permitted, the law may be ignored, and appellate review is not available.

Judge Knapp also erred in finding that he had the power to appoint a substitute arbitration tribunal. Having found that neither of the arbitration tribunals designated in the alleged arbitration agreements should serve because of their appearance of bias, the court found that it had power to designate the American Arbitration Association as the arbitration tribunal (J.A. 411-12).

Finally, the court erroneously held that the action should be stayed as against the NYSE even though it had no right to arbitration and even though the Trustee would be greatly prejudiced by having to wait until an arbitration was resolved to begin pursuing his case against the NYSE (J.A. 418-19).

Thus, Judge Knapp stayed this case pending arbitration based on stock exchange arbitration provisions even though none of the 21 parties to this action is a member of either of the stock exchanges involved, even though all of

the arbitration clauses are contained in agreements which have been rejected by the Trustee, even though the tribunals prescribed by those clauses are disqualified from serving, even though many of the claims asserted carry with them a statutory right to a federal forum with pre-trial discovery, a judge trained in the law, and appellate review, and even though many of the claims are concededly not subject to arbitration.

ARGUMENT

I

A TRUSTEE IN BANKRUPTCY IS NOT THE SAME ENTITY AS THE BANKRUPT AND IS NOT BOUND BY THE ARBITRATION CONTRACTS OF THE BANKRUPT

The premise underlying Judge Knapp's opinion was that the three alleged arbitration agreements were "generally applicable to the parties at hand" since the Bankrupt had been a member of the NYSE and the AMEX and a party to the realignment agreements (J.A. 407, 421). The Bankrupt, of course, is not a party to this action; it is the Trustee, who was never a member of the NYSE or the AMEX and was not a party to the realignment agreements, who is the plaintiff. Since "the law compels a party to submit his grievance to arbitration only if he has contracted to do so," Gateway Coal Co. v. UMW, 414 U.S. 368, 374 (1974), the district court made a threshold error in treating the Trustee and the Bankrupt as if they were the same legal entity*, in direct conflict with the terms

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* The court confused the Trustee with the Bankrupt at several points in its opinion (J.A. 414-16).

of the Bankruptcy Act and recent decisions of this Court.

In Shopmen's Local 455, Bridge Workers v. Kevin Steel Products, 519 F.2d 698 (2d Cir. 1975), this Court had occasion to emphasize that the trustee and the bankrupt are separate entities with separate rights and duties.* In reversing a decision by Judge Knapp refusing to let a Chapter XI debtor-in-possession reject an executory contract, this Court stated:

> "A debtor-in-possession under Chapter XI or * * * a trustee in a straight bankruptcy proceeding is not the same entity as the pre-bankruptcy company. A new entity is created with its own rights and duties, subject to the supervision of the bankruptcy court." 519 F.2d at 704 (emphasis in original).

More recently, this Court reaffirmed its holding in Kevin Steel as follows:

> "In Kevin Steel * * * * we reasoned that, unless and until the agreement is assumed by the debtor-in-possession, the latter, being a different entity from the pre-bankrupt company, is not a 'party' to the agreement * * * ." Bhd. of Railway Clerks v. REA Express, Inc., 523 F.2d 164, 167 (2d Cir.), cert. denied, 423 U.S. 1017, 1073 (1975, 1976).

This Court has unequivocally held that the trustee's status is not equivalent to that of the bankrupt; his rights and duties are defined by the Bankruptcy Act, not by the contracts of the bankrupt. There is no provision of the

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* It is important to note that the appointment of a trustee does not terminate the legal existence of the bankrupt. The bankrupt continues as a separate entity.

Bankruptcy Act which requires a trustee to arbitrate pursuant to a contract of the bankrupt.* Indeed, the sections of the Bankruptcy Act** which define the trustee's relationship to the contracts of the bankrupt demonstrate that a trustee cannot be bound by the bankrupt's arbitration agreements.

Since the trustee is a "new juridical entity", Id. at 170, and is not a party to the bankrupt's contracts, the trustee may not be forced to arbitrate a dispute that the bankrupt agreed to arbitrate. See Johnson v. England, 356 F.2d 44, 51 (9th Cir.), cert. denied, 384 U.S. 961 (1966).

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* Judge Knapp read Section 26 of the Bankruptcy Act, 11 U.S.C. § 49, which provides that a trustee "may, pursuant to the direction of the court, submit to arbitration any controversy arising in the settlement of the estate", as evidence of a "policy" favoring arbitration (J.A. 414). In fact, even professional advocates of arbitration regard Section 26 as merely permissive, leaving to the trustee's discretion whether to exercise the authority granted. See, e.g., American Arbitration Association, Lawyer's Arbitration Letter No. 12 (November 15, 1962); Domke, The Law and Practice of Commercial Arbitration § 10.06 at 87 (1968).

** See Sections 60b, 67d, 70a, 70b, 70c and 70e of the Act, 11 U.S.C. §§ 96(b), 107(d), 110(a), 110(b), 110(c) and 110(e).

A. The Trustee Cannot Be Compelled To Arbitrate When He Assumes The Status Of A Creditor To Recover Voidable Transfers.

To subject a trustee in bankruptcy to the bankrupt's arbitration agreements is particularly anomalous where, as here, the trustee is suing to recover transfers voidable under the Bankruptcy Act. The complaint in this case contains six counts based on the Trustee's power to recover fraudulent transfers under Section 70e of the Bankruptcy Act, 11 U.S.C. § 110(e), and one count based on his power to recover voidable preferences under Section 60b of the Bankruptcy Act, 11 U.S.C. § 96(b). These are statutory causes of action belonging only to the Trustee; the Bankrupt could never have asserted these causes of action and could never have agreed to submit them to arbitration.

Under Section 70e of the Bankruptcy Act, 11 U.S.C. § 110(e), the trustee is given the status of a creditor of the bankrupt when he sues to recover fraudulent transfers. Thus, Section 70e of the Act expressly provides that the trustee may recover any transfer that could have been avoided by a creditor of the bankrupt under federal or state law. If the claims set forth in counts XVII through XXIII of the complaint had in fact been asserted by a creditor of Walston, they would not have

been subject to any arbitration agreement. Since the trustee stands in the shoes of the creditors, he is not subject to any arbitration agreement either. "In giving the trustee powers such as those creditors would have had under state law, Congress has enabled the trustee to transcend the position the bankrupt himself might have had." Cowans, Bankruptcy Law and Practice § 743 (Supp. 1973).

Courts have recognized that when the trustee sues with the rights and powers of a creditor under Section 70e, he is not subject to defenses which would have barred a suit by the bankrupt. See Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 139 (7th Cir.), cert. denied, 396 U.S. 838 (1969). See also Schneider v. O'Neal, 243 F.2d 914 (8th Cir. 1957). The trustee "is vested with the rights of creditors and is not limited to the rights of the bankrupt * * *"; his suit is "unaffected by the fact that he could not have recovered if he stood only in the shoes of the bankrupt." See Buttrey, supra, 410 F.2d at 139.

The statute clearly confers on the trustee the status of a creditor when he sues under Section 70e; there is no case, statute, or other authority which would subject him to the bankrupt's arbitration agreements when he brings such a suit.

B. The Trustee Cannot Be Compelled To Perform Executory Arbitration Provisions In Contracts He Has Rejected.

Under Section 70b of the Bankruptcy Act, 11 U.S.C. § 110(b), any contract of the bankrupt which is "executory in whole or in part" is deemed rejected unless the trustee acts to assume it within 60 days after the adjudication of bankruptcy. When a contract is rejected, the bankrupt's estate is not relieved of all liability under it. A rejected contract is deemed to have been breached, and the other party to the contract is free to file a claim for damages in the bankruptcy court pursuant to Section 63 of the Bankruptcy Act, 11 U.S.C. § 103. Where the trustee concludes that a contract should continue to be performed because the estate would benefit from the other party's performance, the trustee may assume the contract and obligate himself to carry it out; if it is rejected, however, he has no obligation under it. See generally 4A Collier on Bankruptcy ¶ 70.43 at 524 (14th ed. 1976).

The term "executory" has a well-understood meaning: something is executory if it "is yet to be executed or performed" or "remains to be carried into operation or effect." Black's Law Dictionary 680 (4th ed. 1951). Thus, executory contracts are those calling for some future performance; executed contracts are those under which no further performance can be required.

An arbitration clause is executory prior to the time when arbitration is held, for the clause contemplates future performance. This obvious proposition was recognized by the Supreme Court in Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109 (1924). Summarizing the law as it stood in the year prior to the adoption of the United States Arbitration Act, Justice Brandeis wrote:

> "The Federal courts * * * have * * * denied, in large measure, the aid of their processes to those seeking to enforce executory agreements to arbitrate disputes. * * * If executory, a breach will support an action for damages. * * * If executed,--that is, if the award has been made,--effect will be given to the award in any appropriate proceeding at law, or in equity." Id. at 120-21 (citations and footnote omitted). See also TWU v. Lincoln Mills, 353 U.S. 448, 456 (1957).

Since arbitration clauses are so clearly executory, it is not surprising that prior to the decision below, every court which had considered the question had held that a trustee in bankruptcy could not be compelled to arbitrate unless he had assumed the contract containing the arbitration clause.* See Johnson v. England, 356 F.2d 44 (9th Cir.), cert. denied, 384 U.S. 961 (1966); In re Muskegon Motor Specialities Co., 313 F.2d 841 (6th Cir.), cert. denied, 375 U.S. 832 (1963) (debtor-in-possession);

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* In Schilling v. Canadian Foreign Steamship Co., 190 F. Supp. 462 (S.D.N.Y. 1961), the only case which had ever required a trustee in bankruptcy to arbitrate, the trustee had affirmed the contract and therefore was bound by all of its terms. Cf. Thompson v. Texas Mexican Ry., 328 U.S. 134, 141 (1946); 4A Collier on Bankruptcy ¶ 70.43[1] at 519 (14th ed. 1976).

Local 30, ILGWU v. Hers Apparel Industries, Inc., 76 CCH Lab. Cas. ¶ 10,733 (S.D.N.Y. 1975) (not officially reported) (debtor-in-possession); Allegaert v. Mendiburu (F-75-36- Civil, E.D. Cal. 1975) (not officially reported). See also Knickerbocker Agency, Inc. v. Holz, 4 N.Y.2d 245, 173 N.Y.S.2d 602, 149 N.E.2d 885 (1958). In Johnson v. England, the Ninth Circuit refused to require a trustee in bankruptcy to comply with an arbitration provision in a labor contract:

> "A decision of an arbitrator here would involve interests of parties who never consented to arbitration, namely, the trustee in bankruptcy and the general creditors. They ought not to be bound by the decision of an arbitrator selected by the employer and the union." 356 F.2d at 51.

Similarly, in the Hers Apparel case, Judge Carter concluded that:

> "If the collective bargaining agreement has indeed been rejected and disaffirmed * * * an arbitration article contained in the agreement can no longer be binding." 76 CCH Lab. Cas. ¶ 10,733 at 18,498.

Here, all three contracts containing arbitration clauses--the NYSE membership, the AMEX membership, and the realignment agreements--were rejected by operation of law when the Trustee did not act to assume them within 60 days after adjudication.* Section 70b of the Bankruptcy Act, 11 U.S.C. § 110(b).

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* The district court's finding that the Trustee assumed the realignment agreements by suing on them in his complaint is plainly erroneous. The counts of the complaint to which Judge Knapp referred--Counts XV and XVI--are for an accounting and for conversion, not for breach of contract. Furthermore, the Trustee did not file his complaint until almost one year after the 60 day period for assuming contracts had expired; at that point the realignment agreements had long ago been rejected by operation of law.

Despite the obvious character of the arbitration clauses as executory contractual provisions and despite the wealth of authority holding that trustees in bankruptcy are not bound by the bankrupt's agreements to arbitrate, Judge Knapp found that the arbitration clauses were binding on the Trustee. In substance, Judge Knapp ruled that since there were no future duties or obligations under the contracts as of the date of bankruptcy, the contracts were nonexecutory as of the date of bankruptcy. This, of course, ignores the obligation to arbitrate. Although an agreement to arbitrate is plainly one which must be performed in the future, Judge Knapp held that it was not:

> "An agreement to arbitrate does not create an obligation to perform _in futuro_ * * * " (J.A. 408).

Thus, when the Trustee sought to reject the obligation, Judge Knapp found there was no obligation to reject; yet when the Perot Group sought to impose the obligation on the Trustee, Judge Knapp found that the obligation existed.

The district court apparently reached this unprecedented and anomalous result because of a misunderstanding of this Court's decision in _Tobin v. Plein_, 301 F.2d 378 (2d Cir. 1962), a case in which a trustee in bankruptcy wanted to arbitrate. Tobin, the trustee of a

bankrupt corporation, brought an arbitration proceeding against Plein based on an arbitration clause in a contract to which the bankrupt and Plein had been parties.* Plein resisted arbitration, arguing that the trustee could not enforce the arbitration clause because he had not affirmed the contract containing it within the 60 day period provided by Section 70b of the Bankruptcy Act, 11 U.S.C. § 110(b). This Court held that the trustee could compel Plein to arbitrate.

Since the arbitration clause in Tobin v. Plein was found enforceable by the trustee even though the trustee had not assumed the contract containing it, Judge Knapp apparently concluded that arbitration clauses were not executory contracts subject to disaffirmance under the Act.

Judge Knapp fell into this error by failing to distinguish between two different kinds of contract rights which are dealt with by two different sections in the Bankruptcy Act. For example, on the date of bankruptcy, a bankrupt may have the absolute right to receive delivery of goods under a contract because he has already paid for them; alternatively, he may have the right to receive goods under a contract only if he pays for them. Rights of the first kind pass automatically to the trustee under Section 70a(6) of the Bankruptcy Act, 11 U.S.C. § 110(a)(6), which gives the trustee title to the bankrupt's "rights of action arising upon contracts * * *." See Countryman, Executory Contracts in

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* It appears from the record in the case that Plein was in South America, so that the arbitration tribunal was the only domestic forum in which the trustee could get jurisdiction over Plein.

Bankruptcy : Part I, 57 Minn. L. Rev. 439, 458-59 (1973). If the trustee desires to have rights of the second kind, however, he must assume the burden of carrying out the bankrupt's end of the bargain under Section 70b.

All that this Court held in Tobin v. Plein was that the right to arbitrate was a right of the first type which had passed automatically to the trustee:

> "The trustee is vested by law with any rights of action arising from contracts which the bankrupt may possess. Bankruptcy Act § 70a(6), 11 U.S.C. § 110(a)(6); 4 Collier on Bankruptcy § 70.28 (14th Ed. 1942)." 301 F.2d at 380.

Since the trustee apparently was asserting breaches of contract which occurred prior to bankruptcy,

> "the trustee can maintain these proceedings under the contract, whatever the effect of § 70b on any further rights. * * * [A]ny rights of action accruing to the trustee by virtue of prior acts in breach of such a contract should not be affected by the trustee's election or rejection under § 70b." 301 F.2d at 381.

A party to an arbitration agreement has both (a) a right to demand arbitration and (b) a duty to submit to arbitration if the other party demands it. The right to arbitrate arises upon the signing of the agreement; each party is thereafter entitled without further performance on his part to compel the other party to arbitrate a dispute between them. In Tobin v. Plein, the trustee desired to arbitrate. Since no further performance on his part was required in order to give him this right, the right had passed to him under Section 70(a)(6) of the

Act and he was not required to affirm the contract in order to compel arbitration.

With regard to a duty to submit to arbitration, however, the situation is quite different. A trustee is never obligated to perform a contract he has rejected, and the Trustee has rejected all of the contracts here. It will be observed that the effect of this statutory scheme is that a trustee in bankruptcy may force another party to arbitrate but cannot be compelled to arbitrate himself. There is no inconsistency or unfairness in this. The trustee is appointed by the court to collect the property of the bankrupt, reduce it to cash, and distribute the cash to creditors. In doing so, he may enjoy all property rights of the bankrupt, including rights to arbitrate. However, he is a stranger to the contracts of the bankrupt and cannot be compelled to perform them.

The purpose of relieving the trustee from specifically performing burdensome obligations of the bankrupt would not be served if the trustee were required to perform arbitration clauses in agreements he has rejected. A contract can be burdensome because its performance would involve undue expense or would prevent the trustee from closing the estate expeditiously.* Here,

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* Section 47a of the Bankruptcy Act directs trustees to

> "collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, <u>and close up the estates as expeditiously as is compatible with the best interests of the parties in interest</u>." (Emphasis added).

the Trustee believes the arbitration clauses to be burdensome for both reasons.*

While cost and delay surely are, as Chief Judge Kaufman has said, "the twin demons that plague our judicial system" (Judicial Reform In The Next Century: A Judge Gazes Into The Crystal Ball, Remarks at the New York University Bicentennial Conference, April 29, 1976), and while arbitration is widely ballyhooed as a speedy and inexpensive method of dispute resolution, there are substantial reasons for concluding that arbitration would be far more expensive and much slower than court trial in a case of this kind. Both the objective characteristics of the arbitration process and the opinions of experienced observers support the conclusion that arbitration in a big case is paralyzingly slow and very costly. See generally Costikyan, Some Observations on Arbitration, in Bernstein, Private Dispute Settlement 17 (1968), reprinting 151 N.Y.L.J. (No. 40) p. 1 (Feb. 27, 1964) (hereinafter "Costikyan") ("The consensus of many experienced litigators" is that arbitration does not accomplish its stated objectives of speed, economy, and justice as well as courtroom litigation); Horowitz; Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 76 (1962); Wehringer, Arbitration--Precepts and Principles § 3.2 (1969).

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* The clauses might also be regarded as burdensome in that they would reduce the Trustee's chance of recovery by relegating him to a tribunal providing, in the words of the Supreme Court, "less certainty of legally correct adjustment." Wilko v. Swan, 346 U.S. 427, 438 (1953).

The arbitration proceeding begins with a large expense not encountered in court litigation: the filing fee to cover the cost of the tribunal. Under American Arbitration Association ("AAA") Rules, the complaining party "pays an initial heavy price if his claim is worth any real amount." Wehringer, Arbitration Yes, But What Forum?, 44 N.Y.St.B.J. 391 (1972). For a claim of $100,000 to $200,000, the AAA Rules prescribe a fee of $1,350 plus 1/2% of the excess over $100,000. The Rules state that fees for claims in excess of $200,000 should be discussed with the AAA before filing. Apparently, the AAA has adhered to the 1/2% rate on some claims substantially in excess of $100,000. See Wehringer, Arbitration -- Precepts and Principles § 4.3 at 13 (1969). While the AAA doubtless would demand a somewhat lesser rate on the multimillion dollar claim advanced here, the fact remains that the Trustee could not commence arbitration without payment of thousands of dollars in filing fees.

The filing fee is not the only additional expense of arbitration. While arbitrators ordinarily serve without charge in brief commercial arbitrations, it is customary to pay the arbitrators for service in extended proceedings. See, e.g., Wehringer, Arbitration -- Precepts and Principles § 4.5 at 14 (1969). See also Domke, The Law and Practice of Commercial Arbitration § 42.01 (1968); Horowitz, Guides For Resorting To Commercial Arbitration, 8 Prac. Law. 67, 69 (1962) ("In a court case the public pays * * * the judge * * *"). Arbitrators' fees

may run to thousands of dollars a day. See, e.g., Electrical Research Products, Inc. v. Vitaphone Corp., 20 Del. Ch. 417, 171 A. 738 (1934).

The advantage of speed which is claimed for arbitration is also unlikely to be present in a complex case. Arbitrators, who have their own businesses or professions which must be conducted, cannot be expected to sit day-to-day in an extended proceeding. Costikyan at 18. And,

> "if the arbitrators cannot accommodate their own calendars to the needs of the arbitration proceedings, a speedy determination will not follow." Horowitz, Guides For Resorting To Commerical Arbitration, 8 Prac. Law. 67, 70 (1962).

One commentator cites a case in which twenty-six arbitration sessions took two years to complete.* In another reported case, after 32 hearings over a two-year period, one of the arbitrators resigned because he had acquired a conflict of interest; a second group of 30 hearings generating 4,079 pages of transcript were held before a substitute arbitrator when the proceeding bogged down again since the substitute arbitrator's other commitments frustrated efforts to schedule further hearings. See Electrical Research Products, Inc. v. Vitaphone Corp., 20 Del. Ch. 417, 171 A. 738 (1934). Discontinuities in presentation caused by

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* Ballantine Books, Inc. v. Capital Distributing Co., 302 F.2d 17, 18 (2d Cir. 1962) ("adjournments and frequent delays"), cited in Costikyan at 18. See also Cia De Navegacion Omsil, S.A. v. Hugo Neu Corp., 359 F. Supp. 898 (S.D.N.Y. 1973).

arbitrators' inability to sit from day-to-day themselves create more delay, for evidence must be repeated endlessly and memories continually refreshed. Costikyan at 18.

Here, where a court trial of several weeks duration will doubtless be required, arbitration hearings could easily stretch over a period of several years. Of course, an important consequence of delay of this kind is additional expense. The discontinuity of the arbitration process, the consequent repetition, and the tendency of arbitrators to take all evidence for what it is worth, make the cost of trial before arbitrators considerably more expensive than a court trial of the same issues; "With an impecunious or faint-hearted client, such financial burdens produce great pressure for settlement." Costikyan at 18.

It would be an ironic result indeed for the trustee appointed by the court to recover assets of the bankrupt for the benefit of its many unpaid creditors to be told by the court that he is banished from the publicly-financed court system and must seek redress before a private tribunal which will charge him dearly for the privilege.

II

THE TRUSTEE'S STATUTORY CLAIMS ARISING UNDER THE BANKRUPTCY ACT AND THE SECURITIES LAWS ARE NOT ARBITRABLE

The Trustee's complaint contains seven counts based on the Trustee's statutory power to recover voidable transfers

arising under the Bankruptcy Act (Counts XVII-XXIII) and eight counts to enforce liabilities arising under the federal securities laws (Counts I-VIII). Even if a trustee would be bound by the bankrupt's arbitration agreements when suing on contract claims, he cannot be bound to arbitrate these statutory claims arising under the Bankruptcy Act or the securities laws.

A. The Trustee's Claims Alleging Fraudulent Or Preferential Transfers Are Not Arbitrable.

While seeking to set aside fraudulent or preferential transfers under Sections 60b, 67d and 70e of The Bankruptcy Act, a trustee is asserting statutory causes of action belonging only to him; they are causes of action that were never the property of the bankrupt. Courts have recognized that arbitration tribunals are not the equal of courts in reaching decisions in accordance with law. Where arbitration has been permitted, it has been on the theory that arbitration was agreed to by the parties. May a bankrupt bind a trustee "to accept less certainty of legally correct adjustment"* of rights which the bankrupt never owned? In a decision wholly without precedent, Judge Knapp held that a trustee could be so bound.

In so ruling, Judge Knapp overlooked the relevant sections of the Bankruptcy Act, misread this Court's prior decisions,

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* Wilko v. Swan, 346 U.S. 427, 438 (1953) (footnote omitted). Compare Learned Hand's phrase in American Almond Products Co. v. Consolidated Pecan Sales Co., 144 F.2d 448, 451 (2d Cir. 1944) ("looser approximations to the enforcement of * * * rights than those that the law accords * * *").

and failed to apply the analysis prescribed by this Court for determining whether federal statutory causes of action are arbitrable. Indeed, none of the four reasons Judge Knapp gave for his ruling lends it support.

First, Judge Knapp held that the Trustee's right to assert claims in a federal forum was not a part of his statutory right to recover preferential or fraudulent transfers (J.A. 413). However, a number of Supreme Court decisions have clearly held that the forum is an important part of a cause of action and that a change from a judicial forum to an arbitration forum could result in a case being decided quite differently:

> "[T]he remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State. The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result." Bernhardt v. Polygraphic Co., 350 U.S. 198, 203 (1956). See also Alexander v. Gardner-Denver Co., 415 U.S. 36, 56 (1974); Wilko v. Swan, 346 U.S. 427, 435-38 (1953).

Second, Judge Knapp concluded that there was nothing in the Bankruptcy Act that gave the Trustee a right to choice of forum (J.A. 414), quoting a passage from this Court's decision in Fallick v. Kehr, 369 F.2d 899, 904 (2d Cir. 1966), to the effect that nothing in the Bankruptcy Act gave the bankrupt an absolute right to choice of forum. In fact, four sections of the Bankruptcy Act--Sections 23b, 60b, 67d and 70e, all cited to but

ignored by the district court--do grant the trustee the right to choice of forum. These sections, enacted in 1903 in response to a decision restricting the trustee's choice of forum, all permit the trustee to sue in federal court to recover fraudulent or preferential transfers without regard to diversity of citizenship or amount in controversy. See Williams v. Austrian, 331 U.S. 642, 644 (1947).

The 2-1 decision in Fallick v. Kehr not only is not authority for the trustee's rights under the Bankruptcy Act, but also is no longer good law in its own context by reason of amendments to the Bankruptcy Act. Kehr had sued Fallick for misappropriation of partnership funds, and Fallick had forced the dispute into arbitration pursuant to an arbitration agreement. Fallick then went into bankruptcy and the arbitration proceeding was stayed. When the bankruptcy proceedings were completed and Fallick was discharged, Kehr sought to resume arbitration. Fallick resisted on the ground that the arbitrator was prohibited from determining whether or not the debt was one of those extinguished by the discharge in bankruptcy.

A majority of a panel of this Court held that a refusal to stay the arbitration proceeding was not an abuse of discretion. At the time, absent "unusual circumstances," questions as to the effect of a discharge in bankruptcy were ordinarily decided in the court in which the creditor sued--usually state court--rather than in bankruptcy court. Since the Act gave the bankrupt "no absolute right to choice of

forum," 369 F.2d at 904, and arbitration appeared "no less appropriate than litigation in a state court", Judge Feinberg found no statutory basis for barring arbitration. Id. at 905. Had Congress granted a right to a federal forum, the result would have been different:

> "An advance agreement to waive the benefits of the Act would be void." Id. at 904.

Judge Feinberg noted that "It may well be that Congress should remedy this state of affairs," (Id.; footnote omitted), and after Judge Feinberg's decision, Congress did so. Section 17c of the Act, 11 U.S.C. § 35(c), now provides that the bankruptcy court has exclusive jurisdiction to determine the dischargeability of a debt of the kind asserted by Kehr.* Thus, Congress has moved further in the direction of placing bankruptcy matters exclusively within the jurisdiction of federal courts:

> "Since this is a Federal statute, the Federal courts necessarily have the final word as to the meanin of any terms contained therein." H.R. Rep. No. 91-1502, 91st Cong., 2d Sess. (1970), 2 U.S. Code Congressional & Administrative News 4163 (1970).

In these circumstances, Fallick v. Kehr provides no support for the district court's decision.

Judge Knapp also found that there was a "rule" in this circuit that a trustee in bankruptcy could be compelled to arbitrate, citing two cases. The first case, Tobin v. Plein, 301

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* As to certain other categories of debts, the bankruptcy court has concurrent jurisdiction with other courts but has power to enjoin other courts from proceeding. See Bankruptcy Act § 17c(3),(4), 11 U.S.C. § 35(c)(3),(4).

F.2d 378 (2d Cir. 1962), discussed at pp. 19-22, supra, involved a trustee in bankruptcy who wanted to arbitrate and was seeking to compel another party to do so. The second case, Schilling v. Canadian Foreign Steamship Co., 190 F. Supp. 462 (S.D.N.Y. 1961), was not a suit by a trustee under the Bankruptcy Act but was a suit by a trustee on a contract which he had affirmed. The fact is that prior to the decision below there was no case in any circuit which had held that a trustee in bankruptcy could be compelled (a) to arbitrate a suit to recover fraudulent transfers or preferences or (b) to arbitrate under a contract the trustee had rejected.

Finally, Judge Knapp stated that the reference in the NYSE Constitution to "dissolution" manifested an "intent" to arbitrate disputes involving bankruptcy (J.A. 414). The question, however, is the "intent" of Congress in framing the Bankruptcy Act. Whatever the scope of the NYSE's self-regulatory authority under the Securities Exchange Act, it hardly extends to amending the Bankruptcy Act.

What Judge Knapp failed to do was to undertake the analysis required by the cases for determining whether a dispute arising under a federal statute is arbitrable. Both the statutory rights sought to be asserted and the suitability of arbitration as a forum for vindicating those rights must be carefully examined. Following such examinations, courts have held that parties to arbitration agreements are not bound to arbitrate disputes under a number of important federal statutes. See,

e.g., Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974) (Title VII of the Civil Rights Act of 1964); U.S. Bulk Carriers, Inc. v. Arguelles, 400 U.S. 351 (1971) (Seaman's Wage Claim); Wilko v. Swan, 346 U.S. 427 (1953) (Securities Act); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) (Antitrust laws); L.O. Koven & Brother, Inc. v. Steelworkers' Local 5767, 381 F.2d 196 (3d Cir. 1967) (Bankruptcy Act). In the American Safety case, this Court looked to three factors in determining that a claim under the antitrust laws was "of a character inappropriate for enforcement by arbitration":*

1. the degree of public interest in the dispute;

2. the extent to which the agreement to arbitrate was a product of free choice; and

3. the degree to which the complexity of the issues and the extent and diversity of the evidence made the case better suited to judicial procedures. 391 F.2d at 827.

In the case at bar each of these factors weighs heavily in favor of enforcement of the Trustee's claims in a judicial forum. First, the claims are permeated with a strong public interest. We are concerned here with the largest brokerage house failure in our nation's history. The events at issue have received extensive public comment. See, e.g., Welles, The Last Days of the Club 258-66 (1975); Rustin, Who

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* American Safety Equipment Corp. v. J.P. Maguire & Co., supra, 391 F.2d at 825, quoting Wilko v. Swan, 201 F.2d 439, 444 (2d Cir.), rev'd, 346 U.S. 427 (1953).

Bailed Out Whom When Walston Joined With duPont Glore Forgan?, Wall Street Journal p. 1 (August 13, 1973). The outcome of this dispute will affect the lives and fortunes of hundreds of people and institutions.

If cases involving important questions of public policy are sent to arbitrators, the law will be made by persons "who are unresponsive and unresponsible to society in general." Note, Commercial Arbitration: Expanding the Judicial Role, 52 Minn. L. Rev. 1218, 1230 (1968). See generally Kronstein, Arbitration is Power, 38 N.Y.U.L. Rev. 661 (1963). This aspect of arbitration has been a subject of increasing judicial concern. See, e.g., Alexander v. Gardner-Denver Co., 415 U.S. 36, 57 (1974); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 826-27 (2d Cir. 1968); L.O. Koven & Brother, Inc. v. Steelworkers' Local 5767, 381 F.2d 196, 202 (3d Cir. 1967).

In Alexander v. Gardner-Denver Co., supra, the Supreme Court pointed out that an arbitrator is not "a public tribunal imposed upon the parties" which is authorized "to administer justice for a community which transcends the parties." 415 U.S. at 53 n.16, quoting Shulman, Reason, Contract, and Law in Labor Relations, 68 Harv. L. Rev. 999, 1016 (1955). Such a tribunal, the court concluded, was not suitable for adjudication of statutory rights under Title VII:

> "the resolution of statutory or constitutional issues is a primary responsibility of courts, and judicial construction has proved especially necessary with respect to

> Title VII, whose broad language frequently can be given meaning only by reference to public law concepts." Id. at 57.

And in the Koven case, the Third Circuit held that a question involving the proper interpretation of the Bankruptcy Act should be decided by a judge rather than by an arbitrator:

> "The uniform application and development of federal bankruptcy policy depends on entrusting its operation to a forum which defines issues of fact and law sufficiently to permit review of its decision on the merits." Id. at 201 (footnote omitted).

Second, arbitration is not appropriate because the arbitration agreements were hardly a product of free choice. As a giant brokerage house doing business in 49 states, Walston needed to belong to the NYSE and the AMEX; and agreement to the arbitration provisions of the constitutions of those stock exchanges is a mandatory term of membership.

Finally, the nature of the questions of fact and law presented make arbitration a far inferior tribunal for their resolution. In federal court the judge has been appointed by the President of the United States with the advice and consent of the Senate. He is experienced in trying cases and has expertise in interpreting and applying the often difficult concepts involved in bankruptcy law and securities law.

The arbitrator is chosen from a panel selected by a private organization. Whether the arbitrator will be the equal of federal judges in ability and character is a matter of chance,

but the arbitrator almost certainly will be inexperienced in judging controversies. A case of this magnitude and public importance should not be decided by "occasional, part-time amateurs."* The parties, the creditors and the stockholders of Walston and the public are entitled to a trial before "a judge who is trained and skilled, who is a part of the judicial tradition, and who is protected by tenure." Hays, Labor Arbitration: A Dissenting View 118 (1966).

There are a number of significant deficiencies in the procedures for trial and determination of arbitrations under American Arbitration Association Rules which make arbitration inappropriate in a case of this kind.

1. One of the most serious deficiencies is the absence of pre-trial discovery.** The plaintiff is a trustee in bankruptcy. Unlike an operating business, he employs no witnesses with knowledge of the relevant facts. And because of the peculiar circumstances of this case, he has almost none of the relevant records. Pursuant to the transaction under attack in this lawsuit, Walston and defendant duPont Glore Forgan, which theretofore had been full-service brokerage firms, each assumed

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* Costikyan at 17.

** Pre-trial discovery is not available as part of the arbitration process and has been permitted by courts only in extraordinary circumstances. See, e.g., Domke, The Law and Practice of Commercial Arbitration § 27.01 (1968); Horowitz, Guides For Resorting to Commercial Arbitration, 8 Prac. Law. 67, 75 (1962). See also Alexander v. Gardner-Denver Co., 415 U.S. 36, 57-58 (1974).

only a portion of the functions of a single brokerage business. All "back-office" functions -- accounting, recordkeeping, and the like -- were performed by duPont Glore Forgan (J.A. 40, 120). Thus, the Trustee has virtually no financial or accounting records of the Bankrupt for the period after the transaction with duPont Glore Forgan was implemented.

Walston was a nation-wide brokerage firm and one of the largest in the business. The proof of the facts alleged in the complaint will reflect this size and geographic diversity. The complaint names 20 defendants. Process was served on these defendants in the states of New York, Delaware, California, Texas and New Jersey. Witnesses will include residents of Florida and other states. The twenty-four counts in the complaint charge violations of numerous provisions of the federal securities laws, the Bankruptcy Act, and state law. At issue are hundreds of transactions between and among Walston, duPont Glore Forgan, and other entities and individuals. This is a case in which review of thousands of documents and examination of numerous witnesses are essential to an orderly and effective presentation before the trier of fact. Since discovery is not available in arbitration, this suit is one of those which is not appropriate for arbitration; cases "involving difficult questions of law or fact where pre-trial procedures are likely to be of substantial assistance" belong in court. Horowitz, Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 76 (1962).

2. Arbitrators are not required to follow the rules of evidence. See, e.g., Alexander v. Gardner-Denver Co., 415 U.S. 36, 57 (1974); Bernhardt v. Polygraphic Co., 350 U.S. 198, 203 n. 4 (1956). Indeed, "affidavits play an important role as evidence in arbitration when a witness cannot be available at the hearing." Domke, The Law and Practice of Commercial Arbitration § 24.02 at 239 (1968). With the number of witnesses from other states, the complexity of the issues, and the importance of credibility in this case, proof by affidavits would be most unsatisfactory. Cf. Wilko v. Swan, 346 U.S. 427, 435-36 (1953) (application of the Securities Act would be less effective in arbitration than in court where case required "subjective findings on the purpose and knowledge of an alleged violator of the Act"); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 827 (2d Cir. 1968) ("antitrust cases are prone to be complicated, and the evidence extensive and diverse, far better suited to judicial than to arbitration procedures").

3. Arbitrators need not follow the applicable substantive law:

> "[A]rbitrators are permitted to follow their own notions of justice, whether or not in conformity with legal rules, legal doctrine, or legal principle * * *." Horowitz, Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 73 (1962). See also Herzog, Judicial Review of Arbitration Proceedings - A Present Need, 5 dePaul L. Rev. 14, 27 (1955); Domke, Commercial Arbitration 13 (1965).

Thus, one could have no confidence that the public policies embraced in the provisions of the Bankruptcy Act and the

securities laws involved in this important case would be carried out by an arbitrator.

4. Arbitration hearings are held in private. This is often claimed as an advantage of arbitration. See, e.g., Horowitz, Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 70, 75 (1962). The NYSE itself has touted privacy as an important feature of the NYSE arbitration scheme. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 134 (1973). Here, however, we are concerned with a matter of great public interest. Serious violations of the law have been charged to prominent people and institutions, notably the NYSE itself. This controversy should not be "muffl[ed] * * * in the cloakroom of arbitration," Id. at 136; a public trial should be had.

5. The American Arbitration Assocation "puts enormous pressure on its arbitrators not to write opinions * * *."* Mentschikoff, Commercial Arbitration, 61 Colum. L. Rev. 846, 857 (1961). The Association is quite unabashed in its reasons for discouraging written opinions: it does not want courts to know just how bad a job its arbitrators are doing. As this Court put it in I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 429 (2d Cir. 1974), "the AAA apparently discourages the practice of written arbitral opinions in order to insulate the

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* Arbitrators are not required to give any reasons for their decisions. See, e.g., Alexander v. Gardner-Denver Co., 415 U.S. 36, 58 (1974); Bernhardt v. Polygraphic Co., 350 U.S. 198, 203 (1956); Wilko v. Swan, 346 U.S. 427, 436 (1953).

arbitral process from any judicial review." (footnote omitted). In its Manual for Commercial Arbitrators (1975), the Association states that one reason for its policy is that

> "written opinions might open avenues for attack on the award by the losing party.
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> "[A] party losing an arbitration may occasionally seek a way to upset an award in court, and a carelessly expressed thought in a written opinion might afford an opportunity to delay enforcement of the award." Id. at 18. See also Domke, The Law and Practice of Commercial Arbitration § 29.06 at 286-87 (1968).

In federal court, the rules require written findings of fact and conclusions of law in a judge-tried case. The requirement of written reasons encourages careful reflection and analytical precision and builds confidence in the parties and the public in the integrity and competence of the tribunal. See Horowitz, Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 73 (1962).

6. Arbitration awards are subject to judicial review only on a few specific and narrow grounds.* See, e.g., Wilko v. Swan, 346 U.S. 427, 436 (1953). In general, arbitration awards are subject to attack only on such grounds as fraud or corruption. See 9 U.S.C. § 10. Significantly, a party to an arbitra-

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* Because of the practice of arbitrators of not giving reasons for their awards, even this limited review may be more apparent than real. See, e.g., I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 429 (2d Cir. 1974); Domke, The Law and Practice of Commercial Arbitration § 25.04 at 260 (1968); Horowitz, Guides for Resorting to Commercial Arbitration, 8 Prac. Law. 67, 72 (1962).

tion cannot object because the arbitrator was wrong on the law or wrong on the facts.* See, e.g., I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 429 (2d Cir. 1974). See generally Domke, The Law and Practice of Commercial Arbitration, Ch. 34 (1968).

Thus, in Johnson v. England, 356 F.2d 44, 51 (9th Cir.), cert. denied, 384 U.S. 961 (1966), the court cited the absence of appellate review in refusing to require trustees in bankruptcy to arbitrate:

> "[I]f appellants had their way and arbitrators were put in a position to decide [in favor of appellants], such a decision would not be subject to full judicial review in any court, (see United Steelworkers of America v. Warrior & Gulf Co., 363 U.S. 574, 80 S. Ct. 1347). That ought not to happen to these general creditors."

In the face of all of these characteristics of the arbitration process, it comes as no surprise to learn that courts** and commentators*** regard arbitration as inappropriate for the big case with important legal issues, and that even the literature produced by the arbitration industry itself

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* Some cases state that an award would be open to challenge for "manifest" disregard for the law, but this is taken to mean something close to willful refusal to apply the law and in practice is seldom, if ever, found. See generally Domke, The Law and Practice of Commercial Arbitration § 25.05 (1968 and 1975 Supp.).

** See, e.g., Wilko v. Swan, 346 U.S. 427, 435-36 (1953); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 827 (2d Cir. 1968).

*** Horowitz, Guides For Resorting to Commercial Arbitration, 8 Prac. Law. 67, 76 (1962); Wehringer, Arbitration -- Precepts and Principles § 3.2 (1969).

emphasizes the utility of arbitration only with respect to run of the mine disputes not involving significant questions of law.*

Congress placed the responsibility of deciding Bankruptcy Act cases in the federal courts; that is where this case belongs. "There was no occasion here for the court to abdicate its judicial functions." In re Muskegon Motor Specialties Co., 313 F.2d 841, 843 (6th Cir.), cert. denied, 375 U.S. 832 (1963).

B. The Trustee's Claims Under The Securities Laws Are Not Arbitrable.

Like the Bankruptcy Act, the federal securities laws give plaintiffs the right to sue in federal court without regard to amount in controversy. And for the same reasons that the arbitral forum is an inferior tribunal for adjudication of suits to recover fraudulent transfers and preferences, it is an inadequate forum for litigation of securities laws claims. In the leading case of Wilko v. Swan, 346 U.S. 427, 435-36 (1953), the Supreme Court held that a Securities Act claim could be advanced in federal court despite the existence of an arbitration agreement:

> "This case requires subjective findings on the purpose and knowledge of an alleged

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* See, e.g., American Arbitration Association, A Businessman's Guide to Arbitration 3 (1976); Domke, Commercial Arbitration 13 (1965); American Arbitration Association, Suggestions for the Practice of Commerical Arbitration in the United States 5 (1928).

> violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact'* * * cannot be examined. Power to vacate an award is limited." (footnote omitted).

In these circumstances, the Court found that the arbitration clause was an attempt to waive a right under the Securities Act--the right to bring suit in federal court--and was void under the non-waiver provision of the Act.* The Wilko rule, which later cases have extended to suits under the Securities Exchange Act of 1934, was reaffirmed by this Court in Greater Continental Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970). Noting that there was a "strong federal policy in favor of determining stock fraud questions in the federal courts" rather than in arbitration tribunals, Judge Smith explained why:

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* Section 14 of the Securities Act of 1933, 15 U.S.C. § 77n, provides as follows:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

The Securities Exchange Act of 1934 contains a similar provision. Section 29(a), 15 U.S.C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

> "[A] question concerning fraud within the meaning of Rule 10b-5 is properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made. It was for that reason that in both the 1933 and 1934 securities acts Congress provided that questions arising under those acts were not to be determined in arbitration proceedings (but rather in the courts) even if the contract between the parties contained an arbitration provision." 422 F.2d at 1103 (citations omitted).

The Perot Group has sought to fit itself within a narrow exception to the Wilko rule first created by Judge Cooper in Brown v. Gilligan, Will & Co., 287 F. Supp. 766 (S.D.N.Y. 1968), and subsequently applied by this Court in Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838 (2d Cir. 1971). Cf. Coenen v. R.W. Pressprich & Co., 453 F.2d 1209, 1214 (2d Cir.), cert. denied, 406 U.S. 949 (1972) (arbitration agreement entered into after dispute arose). In Gilligan, Will, Judge Cooper held that despite Wilko, a stock exchange member could be required to arbitrate 1933 Act and 1934 Act claims. Judge Cooper found first that

> "These provisions requiring arbitration are in furtherance of Congressional purpose--self-regulation of exchanges--and set forth a desirable procedure for settling disputes between exchange members," 287 F. Supp. at 774,

and second, that the non-waiver provisions in both the 1933 and the 1934 Acts were qualified by Section 28(b) of the 1934 Act, 15 U.S.C. § 78bb(b), which provides that nothing in the 1934 Act

> "shall be construed to modify existing law * * * with regard to the binding effect on any member of any exchange of any action

taken by the authorities of such exchange to settle disputes between its members * * *."

The Perot Group's efforts to fit within the Gilligan, Will exception must fail (1) because this dispute is not within the language of the exception to the non-waiver provisions created by Section 28(b) and (2) because Judge Cooper's finding as to the importance of arbitration to the purposes of the 1934 Act is substantially undercut by the Supreme Court's subsequent decision in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117 (1973).

Section 28(b) has been read in accordance with its "plain and unambiguous language." See Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., CCH Fed. Sec. L. Rep. ¶ 95,643 (3d Cir. 1976) (not yet officially reported). Looking to the plain language of the statute, it is apparent that Section 28(b) has no application here. Section 28(b) applies only to exchange "members." None of the parties to this dispute is an exchange member.

The Trustee was never a member, and the Bankrupt whose estate he is administering has long since ceased to be a member. Eight of the twenty defendants never had memberships in either the NYSE or the AMEX, and the remaining defendants have all given up their memberships. While the giving up of a stock exchange membership may not terminate an arbitration clause as a matter of contract, see, e.g., Isaacson v. Hayden, Stone Inc., 319 F. Supp. 929 (S.D.N.Y. 1970), it does prevent

enforcement of the clause in disputes involving violations of the securities laws because the Section 28(b) exception applies only to members. This result is entirely appropriate. Since none of the parties to the case are stock exchange members or public customers, the exchanges have no regulatory interest in arbitration of this dispute. This is not a case in which it is important to preserve ongoing relationships between the parties or where knowledge of customs and practices of securities trading is valuable in resolving the dispute. The interest involved in this suit is the interest in having a suit on behalf of victims of a fraud in violation of the federal securities laws tried before a judge in federal court.

In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, the Supreme Court considered NYSE Rule 347(b), a rule requiring arbitration of disputes between member firms and their employees, as applied to a dispute not relating to securities trading. The question presented was whether the arbitration rule was in furtherance of the purposes of the 1934 Act or was merely a housekeeping provision which could be superseded by state law. In his opinion for the Court, Justice Blackmun concluded that arbitration of such disputes did not further the statutory purpose. Noting that "there is nothing in the Act and there is no Commission rule or regulation that specifies arbitration as the favored means of resolving employer-employee disputes," the Court found that "the relationship between

compulsory employer-employee arbitration and fair dealing and investor protection is 'extremely attenuated and peripheral, if it exists at all,'" 414 U.S. at 135, quoting the Government's *amicus curiae* brief at 9. In response to an argument that the avoidance of public airing of disputes would prevent shaking of investor confidence in the market, Justice Blackmun responded:

> "It is difficult to understand why muffling a grievance in the cloakroom of arbitration would prevent lessening of confidence in the market. To the contrary, for the generally sophisticated investing public, market confidence may tend to be restored in the light of impartial public court adjudication." *Id.* at 136.

Since arbitration provisions have no close relationship to the purposes of the 1934 Act, there is no occasion for giving an expansive reading to the Section 28(b) exception to the non-waiver provision in order to permit arbitration.

III.

THE TRUSTEE IS NOT OBLIGATED TO ARBITRATE BECAUSE NONE OF THE ARBITRATION AGREEMENTS ALLEGED WOULD HAVE BEEN ENFORCEABLE AGAINST THE BANKRUPT

The Perot Group alleged three arbitration agreements by Walston as obligating the Trustee to arbitrate the issues presented in this lawsuit. The two principal arbitration provisions were those in the constitutions of the NYSE* and the AMEX.** The third arbitration clause is contained in one of the realignment agreements allegedly entered into by Walston and calls for arbitration between Walston and duPont Glore Forgan before the NYSE or, in circumstances not here presented, before

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* Article VIII, section 1 of the NYSE Constitution provides:

> "Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the constitution and the rules of the Board of Directors."

** Article VIII, section 1 of the AMEX Constitution provides:

> "Members, member firms, partners of member firms, member corporations and officers of member corporations shall arbitrate all controversies arising in connection with their business between or among themselves or between them and their customers as required by any customer's agreement or, in the absence of a written agreement, if the customer chooses to arbitrate."

other stock exchanges.* As the Perot Group noted below, "it is obvious from a reading of the clause that it represents nothing more than a contractual codification of the parties' obligations as member firms of the various national securities exchanges * * *." (Perot Group reply brief in the district court, at 42).

While Judge Knapp held all three agreements enforceable,** it is not clear which one he purported to enforce, for he

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* Article 10.11 of the Master Agreement provides as follows:

> "Arbitration. duPont and Walston agreed to submit any dispute arising under this Agreement and the Ancillary Agreements [which together are the Realignment Agreements] or with respect to any of the transactions contemplated thereby to arbitration, in accordance with the provisions of the Constitution of the NYSE and the Rules of the NYSE, except that disputes under the Clearing Agreement relating to transactions executed on an exchange other than on the NYSE, which has in its constitution or rules provisions compelling arbitration among members thereof, shall be submitted to arbitration in accordance with the Constitution and Rules of such other exchange."

** Judge Knapp's conclusion that he had power to enforce the arbitration clause in the Master Agreement is clear error. If the making of an arbitration agreement is in issue (see, e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967); Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942); 9 U.S.C. § 4), or there is an allegation of fraud in the inducement of the arbitration clause itself (see, e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co., supra), those issues must be tried before arbitration can be ordered. Here, both issues were presented. Under Section 144 of the Delaware General Corporation Law, an agreement is not valid if the votes of interested directors were necessary to majority approval unless the agreement is "fair." The Trustee's complaint alleges that the majority in the 10-9 vote in favor of the agreements included at least 2 interested directors and that the agreements were unfair. Furthermore, the complaint alleges that the NYSE misrepresented material facts to Walston, a circumstance which, if known, would hardly have led Walston to specify the NYSE as the arbitration tribunal. Hence, there was an issue as to fraudulent inducement of the arbitration clause itself.

in case of a "lapse" in the naming of an arbitrator or a "vacancy."* This authority is not, however, a general charter permitting the court to alter or amend the agreement of the parties. Rather, the whole purpose of the United States Arbitration Act was to authorize courts to lend their assistance in carrying out the intent of the parties. Framers of the legislation stressed that the Act created no new rights but merely provided a remedy to permit specific enforcement of agreed-upon terms. See, e.g., Remarks of Rep. Graham, 65 Cong. Rec. 1931 (1924). The House Committee on the Judiciary made it quite plain that the statute was designed to permit arbitration contracts to be treated just like other contracts when specific performance was sought:

> "Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement * * *. An arbitration agreement is placed upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924).

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* Section 5 provides as follows:
"If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement, the arbitration shall be by a single arbitrator."

found none of them enforceable in accordance with its terms. The Perot Group had agreed that the NYSE--the tribunal provided by the NYSE Constitution and the Master Agreement--should not serve, and Judge Knapp found that the AMEX should not serve in an arbitration under its constitution in order to avoid the appearance of bias.

What Judge Knapp did was to order that absent some other agreement between the parties, arbitration should be had before the American Arbitration Association in accordance with the "spirit" of the AMEX Constitution (J.A. 419).* Significantly, this did not represent an enforcement of the AMEX Constitution according to its terms. The AMEX arbitration tribunal and, where both members are also NYSE members, the NYSE arbitration tribunal, are the exclusive forums provided by the AMEX Constitution for disputes between members. The American Arbitration Association may be invoked under the AMEX Constitution only in <u>customer</u> disputes and only at the option of the <u>customer</u>.

By what warrant did Judge Knapp appoint an arbitration tribunal different from that agreed upon by the parties? Section 5 of the United States Arbitration Act, 9 U.S.C. § 5, does permit court appointment of arbitrators

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* It should be noted that only 7 of the 16 defendants moving for a stay claim any right to arbitrate under the AMEX Constitution, which limits arbitration to member-member and member-customer disputes.

It follows that the statutory authority to appoint a substitute arbitrator is intended only for those situations in which such an appointment would carry out the intent of the parties. Where the identity of the arbitration tribunal was central to the agreement to arbitrate, appointment of a substitute would be contrary to the intent of the parties.

In a case decided under the New York arbitration statute, which formed the model for the United States Arbitration Act,* Judge Cardozo set forth the standard for determining whether a substitute appointment would be appropriate:

> "Nice distinctions must * * * be drawn between a method of selection that is an auxiliary incident and one so wrought into the substance, so much a part of an organic whole, as to be accounted of the essence. * * * The line of division is often shadowy and doubtful.
>
> * * *
>
> "There may be a dominant intention to arbitrate at all events, the machinery of selection being merely modal and subordinate. If so, the failure of the means will not involve as a consequence the frustration of the end. * * * On the other hand, the promise to arbitrate may be so wedded to the means that the failure of the one will be the destruction of the other." <u>Marchant v. Mead-Morrison Mfg. Co.</u>, 252 N.Y. 284, 295-96, 169 N.E. 386, 389-90 (1929), <u>appeal dismissed</u>, 282 U.S. 808 (1930)(citations omitted).

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* See <u>Hearings on S. 1005 and H.R. 646 Before the Joint Comm. of Subcomms. on the Judiciary</u>, 68th Cong., 1st Sess., 21, 23 (1924).

In accordance with this test, courts have refused to appoint substitute arbitrators where the identity of the original arbitration tribunal was central to the agreement to arbitrate. See, e.g., Marcus v. Meyerson, 5 App. Div. 2d 818, 170 N.Y.S.2d 924 (1st Dep't 1958); Golenbock v. Komoroff, 2 App. Div. 2d 742, 153 N.Y.S.2d 309 (1st Dep't 1956).* Thus, the district court erred in failing to determine whether Walston was evidencing a general intent to arbitrate or whether it was agreeing to arbitrate only if the arbitration could be conducted under NYSE or AMEX auspices when it subscribed to the provisions of the NYSE and AMEX constitutions.

Of course, no broker-dealer has chosen arbitration. Rather, broker-dealers have chosen to become members of the NYSE or the AMEX and have been required to accept the arbitration provision as one of the obligations of that membership. As this Court noted in Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838, 841 (2d Cir. 1971), "Each member firm, by virtue of its admission, agrees to be governed by the Exchange's constitution and rules * * * * including the compulsory arbitration provisions." In these circumstances, although a member is bound by the arbitration provisions, he has not really agreed to them in the sense of desiring them

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* In none of the cases appointing substitute arbitrators cited by the district court was there an allegation that the original arbitration tribunal was central to the agreement of the parties.

as a part of the contract; they are non-negotiable terms which would have played a small, if any, part in the equation of whether to become an exchange member.

To the extent that a member may be said to have agreed to arbitration, however, he has agreed to arbitration of a particular kind: arbitration under exchange auspices before a panel with experience in the trade practices and customs.

Arbitration before the American Arbitration Association is quite a different thing than arbitration before a stock exchange tribunal. As Soia Mentschikoff has pointed out, arbitration at the AAA "differs substantially" from arbitration before self-contained trade groups. *See* Mentschikoff, *Commercial Arbitration*, 61 Colum. L. Rev. 846, 857 (1961).

Arbitration of disputes between members under the NYSE or AMEX constitutions takes place before arbitrators chosen from a small panel of arbitrators* who are members of the exchange or officers of member firms.** Arbitration of disputes before the AAA takes place before arbitrators drawn from a panel of 37,000 people.*** From these facts, it is clear that there will

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* At the present time the NYSE panel has 40 members and the AMEX panel for member disputes has 20. *See* 1 CCH New York Stock Exchange Guide 159; 1 CCH American Stock Exchange Guide 157.

** *See* NYSE Const. Art. VIII, §§ 4-5, 2 CCH New York Stock Exchange Guide ¶¶ 1354-55; AMEX Rules 601-02, 2 CCH American Stock Exchange Guide ¶¶ 9541-42.

*** American Arbitration Association, *A Businessman's Guide to Arbitration* 12 (1976).

be great differences in experience and expertise between arbitrators selected under exchange rules and those selected through the AAA. These facts also show that in arbitration before trade groups, precedent plays an important role, while in arbitration before the AAA, precedent is rarely considered:

> "[I]n all of these associations there is a continuity in the membership of the deciders, which means that the system of precedent operates automatically, for a question decided in one case on the basis of competing norms is unlikely to be decided differently in the next case by the same people. However, the casual system used by the American Arbitration Association, is designed to discourage the use of precedent * * * [by discouraging the preparation of written opinions and permitting arbitrators to sit on only one or two cases a year]." Mentschikoff, Commercial Arbitration, 61 Colum. L. Rev. 846, 857 (1961).

There are other procedural differences as well. Under AAA rules, disputes are heard by a single arbitrator unless the parties have otherwise provided or the AAA has exercised its discretion to appoint additional arbitrators. AAA Commercial Arbitration Rule 16. By contrast, disputes involving $100,000 or more between NYSE members are heard by a panel of five arbitrators and disputes between AMEX members involving $1,000 or more are tried by three arbitrators or, in the AMEX's discretion, five arbitrators. NYSE Const. Art. VIII, § 5, 2 CCH New York Stock Exchange Guide ¶ 1355; AMEX Rule 602, 2 CCH American Stock Exchange Guide ¶ 9542.

There is no reason at all for concluding that Walston's memberships in the NYSE and the AMEX signified

anything more than assent to arbitration before the panels of industry experts maintained by those organizations. Nothing suggests that Walston had a general intent in favor of arbitration; under the agreements at issue, the identity of the tribunals was not "subordinate" or incidental, it was "so wrought into the substance, so much of an organic whole, as to be accounted of the essence." Marchant v. Mead-Morrison Mfg. Co., supra at 295, 169 N.E. at 389. Since Judge Knapp's appointment of a substitute tribunal was not in furtherance of the intent of the parties, it was improper.

IV

WHERE NON-ARBITRABLE ISSUES ARE PRESENT, THE ACTION SHOULD NOT BE STAYED

While the Trustee firmly believes that he is not obligated to arbitrate against any of the defendants, one defendant--the NYSE--concedes that it has no right to arbitrate its dispute with the Trustee.* Yet the district court applied its stay to the NYSE as well. This was error.

The only way in which a stay could possibly save time for the parties or the court would be if the decision of the arbitrator would have collateral estoppel effect on the issues remaining to be tried in the district court.

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* In addition, four defendants who were NYSE and AMEX members--DeTata, Doughty, Blair, and D. Tipp Cullen--did not seek a stay pending arbitration.

For the reasons which follow,* this saving of time is most unlikely to occur and is substantially outweighed by the real prejudice which the stay is causing the Trustee.

First, it is by no means clear that collateral estoppel would be applicable to findings of an arbitrator. While there are a few cases stating without much discussion that decisions of arbitrators may be given collateral estoppel effect, see, e.g., Goldstein v. Doft, 236 F. Supp. 730 (S.D.N.Y. 1964), aff'd per curiam, 353 F.2d 484 (2d Cir. 1965), cert. denied, 383 U.S. 960 (1966), a number of authorities caution against according such weight to the decisions of inferior tribunals, and no case has been found which accorded collateral estoppel weight to the findings of an arbitrator in a suit over which federal courts had exclusive jurisdiction.

As the Seventh Circuit recently noted with regard to the findings of a labor arbitrator, "notions of res judicata are less suited to the informal process of industrial arbitration than to the litigation process * * * ." Local 1114, Electrical Workers v. Honeywell Inc., 522 F.2d 1221, 1228 (7th Cir. 1975). The Restatement of Judgments, which does not purport to deal with the effect of the decisions of arbitrators, authorizes courts to decline to give collateral

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* These reasons also demonstrate that if this Court were to rule that the Trustee was bound by the arbitration agreements but that the securities or bankruptcy law claims were not arbitrable, it would be improper to stay proceedings on the non-arbitrable claims pending arbitration.

estoppel effect to the findings of inferior judicial tribunals which, like arbitration, are characterized by informality. _See_ _Restatement (Second) of Judgments_ § 68.1(c) (Tent. Draft No. 1, 1973). _See also_ _Id._, § 68.1(a),(e). Hence, the Reporters of the _Restatement_ state that

> "the question of preclusive effect should turn in each case on an analysis of the comparative quality and extensiveness of the procedures followed in the two courts, of their relative competence to deal with the particular issue, and of the legislative purpose in allocating jurisdiction between them." _Restatement (Second) of Judgments_ § 68.1 Reporters' Note at 186 (Tent. Draft No. 1, 1973).

See _generally_ Vestal, _Preclusion/Res Judicata Variables: Adjudicating Bodies_, 54 Geo. L. J. 857 (1966). _Cf._ _Alexander v. Gardner-Denver Co._, 415 U.S. 36 (1974) (labor arbitration award not _res_ _judicata_ of Title VII claim). These policies are particularly important in cases such as this where the claims asserted are securities law claims entitled to be tried in federal court. For the same reasons that arbitrators are not entitled to try these claims--lack of discovery, inability to appeal, want of judicial instruction on the law, etc.--they ought not be able to decide them indirectly by determining issues which may be dispositive of the claims. Otherwise, court determination of federal claims would be infected by the determination of controlling issues through the inferior processes of the arbitration tribunal. Indeed, where matters of exclusive federal jurisdiction are involved,

even the decisions of state courts may not be given _res judicata_ effect. _See_, _e.g._, _Restatement (Second) of Judgments_ § 68.1, Comment _e_ (Tent. Draft No. 1, 1973); Note, _Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations_, 53 Va. L. Rev. 1360 (1967); _Lyons v. Westinghouse Electric Corp._, 222 F.2d 184, 188-90 (2d Cir.), _cert. denied_, 350 U.S. 825 (1955).

Second, even assuming collateral estoppel were available as a theoretical matter, it is most doubtful that it would be available as a practical matter. Arbitrators are not required to explain their awards, and the AAA strongly encourages them not to issue written opinions. _See_ pp.38-39, _supra_. If, as is the practice, the arbitrator does not explain his award, there is no way to tell what issues were decided and application of the doctrine of collateral estoppel becomes impossible. _See_ _Lynne Carol Fashions, Inc. v. Cranston Print Works Co._, 453 F.2d 1177, 1185 (3d Cir. 1972).

Given these theoretical and practical barriers to the application of collateral estoppel, no saving of time is likely to be achieved by a stay. Against the ephemeral possibility of such a saving one must weigh the prejudice to the Trustee of staying this action. This the district court failed to do. Indeed, Judge Knapp incorrectly concluded that even if the advantages claimed for the stay failed to materialize, "nothing will have been lost" (J.A. 418).

In fact, much will have been lost. The Trustee regards this action as the most significant asset of the Bankrupt's estate. The Trustee has only limited resources with which to pursue this lawsuit and the handful of other claims that contain any prospect of significant recovery for creditors of Walston. If these claims cannot be pursued successfully, general creditors will receive little or nothing. In these circumstances, the kinds of prejudice which a stay would cause are particularly acute:

<u>The Administration Of The Estate Would Be Needlessly Delayed</u>. If the Trustee may not begin to pursue his court action until after arbitration is completed, years will be added to the process of collecting the estate. Under Section 47 of the Bankruptcy Act, it is the Trustee's duty to "collect and reduce to money the property of the estates * * * and close up the estates as expeditiously as is compatible with the best interests of the parties in interest." At the present time, the Trustee's administrative expenses amount to over $100,000 per year. If the stay is not lifted, administration of the estate will be extended, needless additional administrative expenses will be incurred, and the creditors will have to wait still longer for recompense.

<u>Evidence May Be Lost</u>. Most of the significant events in this action took place more than three years ago. Walston and defendants duPont Glore Forgan, PHM & Co.,

Charleston Investment Company, and E.D. Systems Corporation are no longer active in business. Many of the defendants and witnesses were members of Walston's Board of Directors; some of them are now of advanced years, in poor health, and resident in distant states.

While his orders do not rule out discovery entirely, Judge Knapp has made it quite clear that he will permit discovery only in extraordinary circumstances.* After signing his order implementing his decision on the arbitration motions, Judge Knapp--apparently sua sponte--issued a further order to make it clear that he did not intend by his first order to permit broad discovery. Without the ability to engage in normal discovery, it appears likely that the Trustee will have to wait several years until the completion of the arbitration proceedings in order to obtain necessary evidence from many sources. By that time the evidence might well be unavailable.

The Right To A Federal Forum Would Be Eroded. Even if collateral estoppel were applicable in suits on

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* After motion practice, the Trustee got Judge Knapp's permission to take the deposition of one former Walston director who was elderly and in ill health and resided in Florida, but further deterioration of the witness's health prevented the taking of the deposition. However, the district court refused to permit the Trustee to take the deposition of another former director, a 65-year-old Florida resident, even though the former director could not be compelled to testify by an arbitration tribunal (J.A. 398).

federal claims, the reasons for prescribing a federal forum on these claims in the first instance strongly suggest that prior determination by other tribunals of issues relevant to federal claims should be discouraged. In Mach-Tronics, Inc. v. Zirpoli, 316 F.2d 820 (9th Cir. 1963), the Ninth Circuit issued a writ of mandamus dissolving a stay of a Sherman Act case pending decision of a factually-related state case:

> "It would seem to us to be unthinkable that a federal court having exclusive jurisdiction of a treble damage antitrust suit would tie its own hands by a stay of this kind in order to permit a judge of a state court, without a jury, to make a determination which would rob the federal court of full power to determine all of the fact issues before it." Id. at 833.

In a number of cases involving factually-related federal statutory claims and other claims, courts have held that trial of the federal claims should not be stayed pending arbitration of the other claims; rather, the federal trial should precede arbitration.* See American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 828 (2d Cir. 1968); Ring v. Spina, 148 F.2d 647, 654 (2d Cir. 1945); Varo v. Comprehensive

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* Actually, the cumbersome procedure of first trying the federal issues and then having an arbitration hearing seems quite unnecessary. In the analogous situation where factually-related state claims are asserted with federal claims, "considerations of judicial economy, convenience and fairness to litigants" have led federal courts to exercise pendent jurisdiction and decide both the federal and the state claims. United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966). There is no reason why the same procedure might not be adopted with regard to claims which otherwise would be submitted to arbitration.

Designers, Inc., 504 F.2d 1103 (9th Cir. 1974); Cobb v. Lewis, 488 F.2d 41, 50 (5th Cir. 1974); Shapiro v. Jaslow, 320 F. Supp. 598 (S.D.N.Y. 1970)(Mansfield, J.). See also Greater Continental Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970).

In the American Safety Equipment Corp. case, supra, Judge Feinberg instructed the district court to try the non-arbitrable claims first:

> "The district court should, in the first instance * * * determine so much of the case as may be necessary in order that in the arbitration, if there is one, * * * the arbitrators will not be called upon to determine antitrust issues." 391 F.2d at 828.

And in a securities case, Judge Mansfield, then a district judge, ruled that permitting arbitration of common law claims to go first would frustrate the purpose of giving the federal courts exclusive jurisdiction over securities law claims:

> "[U]nder the circumstances here such procedure is impractical, if not impossible, since we cannot separate out the common law from the federal law issues. Newburger, Loeb cannot render meaningless our exclusive jurisdiction over the Federal Securities Act claim by compelling arbitration of an ancillary pendent dispute. The arbitrator could hardly be expected to decide which issues are common law and which federal securities issues: that is a question for the court." Shapiro v. Jaslow, 320 F. Supp. 598, 600 (S.D.N.Y. 1970).

The case for a stay by the NYSE, a defendant which concedes that it has no right to arbitrate, is weaker still.

The leading case in this Circuit on the question whether a stay pending arbitration should be granted on the application of a defendant who is not a party to the arbitration agreement is Nederlandse Erts-Tankersmaatschappij, N.V. v. Isbrandtsen Co., 339 F.2d 440 (2d Cir. 1964). Noting that the burden was on the defendants to establish the right to a stay, Judge Hays quoted the standards for granting such a stay as expressed by Justice Cardozo:

> "'[T]he power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. How this can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance. * * * True, the suppliant for a stay must make out a clear case of hardship or inequity in being required to go forward, if there is even a fair possibility that the stay for which he prays will work damage to some one else. Only in rare circumstances will a litigant in one cause be compelled to stand aside while a litigant in another settles the rule of law that will define the rights of both.' Landis v. North Am. Co., 299 U.S. 248, 254-55, 57 S. Ct. 163, 166, 81 L. Ed. 153 (1936)." 339 F.2d at 441-42 (emphasis supplied).

Here, the NYSE has wholly failed to demonstrate that this case is one in which the "rare circumstances" justifying a stay are present. Quite clearly, the stay would "work damage" to the Trustee, while the NYSE can point to no "hardship or inequity" which it would incur by having to defend its actions in court on their merits.

CONCLUSION

For the foregoing reasons, the orders appealed from should be reversed.

Dated: New York, New York
August 13, 1976

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

---X

WINTHROP J. ALLEGAERT, As Trustee of duPont Walston Incorporated,

Plaintiff-Appellant,

-against-

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,

Defendants-Appellees,

-and-

DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,

Defendants.

---X

76-7235

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

MARIO A. ROSADO, being duly sworn, deposes and says that he resides at 2809 Barker Avenue, Bronx, New York; that on the 13th day of August, 1976, he served two copies of the Appellant's Brief and one copy of the Joint Appendix on each of the attorneys for the defendants-appellees and the defendants listed below by

mailing a true copy thereof, securely enclosed in a post-paid, properly addressed wrapper, in the mail box under the exclusive care and custody of the United States Postal Service at the corner of Wall Street and Broadway, New York, New York, addressed to said attorneys as follows:

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The above addresses have appeared on the prior papers in this action as the office addresses of said attorneys.

Deponent is over the age of 18 years and not a party to this action.

Maria A Rosado

Sworn to before me this

13th day of August, 1976.

Susan M. Resti

Notary Public

SUSAN M. RESTI
Notary Public, State of New York
No. 31-3566350
Qualified in New York County
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